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NCS - Q4 2015 NCI Building Systems Inc Earnings Call

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PRESENTATION

Operator

Greetings, and welcome to the NCI Building Systems fourth-quarter earnings conference call.

(Operator Instructions)

As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Layne de Alvarez, Vice President, Investor Relations. Please go ahead.

Layne de Alvarez - *NCI Building Systems, Inc. - VP of IR*

Thank you. Good morning, and welcome to NCI Building Systems' call to review the Company's results for the fourth quarter of FY15. The Company's fourth-quarter results were issued last night in a press release that was covered by the financial media.

In keeping with SEC requirements, I advise that during this call, we will be making forward-looking statements that involve risks and uncertainties. Actual outcomes may differ materially from those expected or implied. For a more detailed discussion of the risks and uncertainties that may affect NCI, please review our SEC filings, including the 8-K filed last night. Forward-looking statements speak only as of the date they are made. We undertake no obligation to update any forward-looking statements beyond what is required by applicable securities laws.

In addition, our discussion of operating performance will include non-GAAP financial measures. A reconciliation of these measures with the most directly comparable GAAP measures are included in the earnings release and the CFO commentary, both of which are available on our website.

At this time, I would like to turn the call over to NCI's Chairman, President, and Chief Executive Officer, Norman Chambers.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Good morning, everyone, and welcome to our fourth-quarter 2015 conference call. Joining me this morning are Mark Johnson, our Chief Financial Officer; Todd Moore, our General Counsel; and Layne de Alvarez, our Vice President, Investor Relations. Our fourth-quarter earnings were released last night, so hope you had a chance to review the results. I'll open the call with a few brief comments before I hand it over to Mark, who will offer some color on our fourth-quarter financial performance, and we'll be happy to take your questions.

I'm very pleased to report that our fourth-quarter financial performance was the result of focused execution across our commercial, manufacturing, and supply chain groups. The fourth quarter marks the sixth consecutive quarter of year-over-year improvement in gross profit margin and adjusted EBITDA, which was the objective of the reorganization of our business over the past two years. The flattening and removal of silos in both our manufacturing and commercial organizations enabled a level of collaboration, communication, and team work that continues to drive the meaningful improvement in our ability to overcome headwinds that we may face at any given time.

We achieved our best financial performance since 2008, delivering a 56% year-over-year improvement for the fourth quarter in adjusted EBITDA, despite lackluster economic conditions, low-rise non-residential construction activity that decreased year over year, and steel prices that continued to decline to pricing levels not seen since 2003. In the process, we expanded our adjusted EBITDA margins by 310 basis points, as we took advantage of the operating leverage created by volume increases, driving greater capacity utilization. The significant contributors were our buildings and legacy component brands, which generated a sequential Q4 volume increase of 14.4%.

Even more important, year-over-year volume growth from the same contributors was about 12%. These improvements generated pretax cash flow of $124.7 million. I'm proud of the team's dedication for not only taking effective actions to overcome challenges and deliver results, but more importantly, to elevate our focus on safety. We continue to see opportunities to improve our performance on all fronts and we are moving to do so.

Now, before Mark dives into the numbers, I would like to share some thoughts about FY16. We will continue to work on expanding our margins via our commercial discipline, manufacturing efficiencies, and supply chain contributions. As we get closer to our double-digit EBITDA margin goals, we may see some slowing in the [margin expansion] (corrected by company after the call) rate.

As we mentioned during our third-quarter call, we will move ahead to further optimize our manufacturing footprint over the next 12 to 36 months. We expect to reduce our manufacturing cost structure for an annual run rate benefit of between $15 million and $20 million, which has the potential to improve capacity utilization by as much as 20%. That, of course, will lead to even better leverage and margins.

We expect the choppy market conditions will continue in 2016, given the lukewarm growth and the current economic cycle. The leading indicators that correlate most closely to the actual volumes of low-rise new construction starts are the ABI mixed-use index, residential new starts, and the leading economic indicator. When taken together, these point to a modest growth for low-rise construction in 2016. Regardless, it's worth repeating that we remain committed and focused to growing faster than low-rise market and achieving year-over-year improvement quarter by quarter in order to maximize the earnings that will support share price appreciation for the benefit of all stakeholders.

Now, Mark will take you through the fourth-quarter numbers.

Mark Johnson - *NCI Building Systems, Inc. - CFO*

Thank you, Norm. As a reminder, we have provided a review of our fourth-quarter financials in both the earnings press release and the CFO commentary posted on our website. I'll now take a few minutes to add some additional color to those results.

Adjusted net earnings for the quarter beat the street consensus and were better than the prior year's results. The key drivers of these improved results are both margin improvement and volume growth, as we continue to realize the positive results of improved manufacturing and logistic efficiencies, combined with improved supply chain effectiveness and solid commercial discipline. Also contributing to margin growth was a profitable sales mix of architectural and insulated metal panels.

Our gross margin expanded by approximately 310 basis points during the quarter, and our adjusted EBITDA was at the highest quarterly level since 2008. Our reported net income in the fourth quarter was $18.2 million, or $0.25 per diluted share, compared to $14.1 million, or $0.19 per diluted share, in last year's fourth quarter. Both years were impacted by a number of special items, both positive and negative, but last year's special items were not material in total.

I will now take a few minutes to review those items incurred in our fourth quarter, which are reconciled in the tables accompanying the release. First, on an after-tax basis, we realized $2.3 million in gains from various legal settlements. These gains, however, were more than offset by after-tax charges of $4.6 million for restructuring and impairment actions, $0.7 million of acquisition-related costs, and finally, a $1.4 million short-lived intangible asset amortization expense related to our CENTRIA acquisition.

We have now completed the full amortization of the short-lived intangible assets related to CENTRIA and will not see additional short-lived intangible amortization expenses going forward. Similarly, we will see progressively lower non-operating acquisition-related costs in the first half of 2016 as our initial integration activities are nearing completion.

Speaking for a moment now to the impairment costs included in the special charges just mentioned, during the fourth quarter, we completed the development of plans to improve cost efficiency and optimize our combined manufacturing capabilities, considering our recent acquisitions and restructuring efforts. A non-cash after-tax impairment charge of $3.6 million was recorded to reduce various affected assets to their net realizable value. Excluding the impact of the various special items that I outlined, the Company's 2015 fourth-quarter adjusted net income, a non-GAAP measure, was $22.7 million, or $0.31 per diluted share.

Now to our operating results, in the 2015 fourth quarter, our consolidated revenues increased by approximately $67 million, or 17% from the same period last year. The CENTRIA acquisition contributed $58 million of this growth. The year-over-year revenue improvement in our legacy businesses was driven by strong sales of buildings, components, and insulated metal panel products.

It should be noted that while underlying volumes were up 9% in our buildings group and 15% in our legacy components group, revenue growth rates were dampened by the pass-through of lower steel costs, which have declined approximately 20% over the prior-year period. We estimate that the decline in steel costs resulted in a decline in reported revenue ranging somewhere between $20 million and $23 million as compared to the prior-year quarter.

Despite the muted effect on revenue growth, the underlying volume growth is notable, given that non-residential new construction square footage in the US declined 6% year to date as of October in the most recent Dodd report. Within this report, low-rise starts are growing at a much slower rate than mid- and high-rise projects and as you know, our revenues are highly correlated with the low-rise market. While we are therefore outpacing the market in terms of volume growth, our top-line performance would have been even better if it hadn't been impacted by a rapid decline in steel prices on top of a weak market.

Despite these headwinds, our adjusted operating income in the fourth quarter improved by about $18.7 million, a 75% increase over the prior-year's quarter, reflecting our growth in underlying volumes, margin expansion, and supply chain gains, as well as a $3.7 million contribution from CENTRIA. Similarly, adjusted EBITDA also rose by about $20 million during the quarter, an increase of 56% from the same period last year. Also driven by improved gains, growth in underlying volumes, and incremental contribution from CENTRIA of about $6.2 million.

New booking rates have been choppy during the year, with total annual year-over-year growth of 4.3%. However, in the final quarter of the year, buildings bookings declined modestly, yet customer sentiment remains positive and quoting activity is good. Nevertheless, our buildings backlog, excluding IMPs, ended the year 13% higher than the year-ago period. Including CENTRIA, our backlog was $494.5 million.

I wanted to add a quick comment on our free cash flow generation before I move on to discussing our balance sheet. We define pretax free cash flow as adjusted EBITDA, minus net capital expenditures, plus or minus changes in working capital. During the FY15, we generated $124.7 million in annual pretax free cash flow, which was more than 3 times what we generated in 2014. This growth is reflected of the strong growth in EBITDA for the year and strong working capital management.

Now, a brief look at some items on our balance sheet. We ended the year with a strong cash balance. As of November 1, 2015, we had cash of approximately $99.6 million compared to $66.7 million at the end of FY14. During the fourth quarter, we paid down another $10 million of long-term debt and during the year we repaid just over $41 million. Our net debt leverage ratio at the end of the fourth fiscal quarter improved to 2.7 times from 3.5 times sequentially, and we are now approaching our goal of reducing our net debt leverage ratio to the pre-acquisition level of 2.2 times.

Turning to our outlook, we did outperform the low-rise construction markets and delivered material year-over-year improvements in both gross margin and adjusted EBITDA during our FY15. Our internal strength should be supported by positive indicators in the macro environment. The leading indicators for non-residential construction activity continued to indicate modest growth moving into FY16.

We continue to remain focused on delivering sustained margin expansion and increasing levels of profitability by leveraging our manufacturing, supply chain, and commercial initiatives, while streamlining our cost structure. As we enter our FY16, we have a strong backlog that benefited from an increase in bookings for higher margin architectural and insulated metal panels. As the new year starts unfolding, we continue to streamline our operations, eliminate redundancies, and combine capabilities to best align with our customer opportunities for the foreseeable future.

We currently anticipate delivering the seventh consecutive quarter of year-over-year improvement in gross profit margin and adjusted EBITDA in the first quarter of FY16. In addition, we expect first quarter revenue to be up 10% to 15% on a year-over-year basis, and our gross margins to range between 22.5% and 24%. These ranges take into consideration the seasonal aspect of our business, as we enter the slower part of the construction cycle, and the typical disruptions from the winter weather. Finally, on the whole, we expect 2016 to be a better year than 2015 in terms of both gross margin and EBITDA.

Now, operator, I will turn the call back over to you for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from the line of Lee Jagoda with CJS Securities. Please proceed with your question.

Lee Jagoda - *CJS Securities - Analyst*

Hi, good morning.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Good morning, Lee.

Mark Johnson - *NCI Building Systems, Inc. - CFO*

Good morning.

Lee Jagoda - *CJS Securities - Analyst*

First question for Mark, just in your revenue guidance for Q1, what's the steel price decline assumption year over year?

Mark Johnson - *NCI Building Systems, Inc. - CFO*

Well, we are sitting at a point where steel prices are about 20% lower than they were a year ago. I don't see that materially changing for us in the first quarter, so I estimate it's about a $[15]-million impact on revenue.

Lee Jagoda - *CJS Securities - Analyst*

Okay, and then if I look at your commentary and your CFO commentary regarding gross margin, how much does the increase in volumes play a part in that 300-plus basis point increase in gross margin versus the other factors you call out in the commentary? And how should we think about incremental gross margin leverage from here, given this is the first time since I think Q3 of 2008 that margins have been near these levels?

Mark Johnson - *NCI Building Systems, Inc. - CFO*

Well, certainly the increased volumes we had during the fourth quarter are important because they drive significant operating leverage. We do anticipate seeing incremental volumes over the prior year, and that is a significant contribution to the guidance we're giving for Q1.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

But Lee, we really need to just stay very cautious because of the choppiness of the market. And while sentiment is very good among our customers and quoting activity is good, we still need to stay on the side of caution.

Lee Jagoda - *CJS Securities - Analyst*

Okay, and one more for me and I'll hop back in the queue. With regard to the free cash flow, is the free cash flow you generated this year indicative of the potential for the business going forward? Or are there other working capital or CapEx changes that need to be addressed with the incremental volumes that you would expect?

Mark Johnson - *NCI Building Systems, Inc. - CFO*

Certainly, incremental volumes do generally utilize working capital. We had incremental volumes in 2015 and would generally expect incremental volumes in 2016. So there will be a use of working capital. It's probably worth commenting on the impact that steel prices have on working capital, so declining steel prices do free up dollars from inventory. And as transactional prices are lower, it does free up working capital out of receivables. So we did have some tail wind during 2015 as a result of the decline in steel prices. It's probably on the order of $15 million to $20 million impact, and depending on the direction of steel prices for 2016, that could reverse course.

Lee Jagoda - *CJS Securities - Analyst*

If steel prices were to stay where they are today, would it still be an incremental benefit to you in FY16?

Mark Johnson - *NCI Building Systems, Inc. - CFO*

No. It would not be an incremental benefit from this point.

Lee Jagoda - *CJS Securities - Analyst*

Okay.

Mark Johnson - *NCI Building Systems, Inc. - CFO*

It would be neutral.

Lee Jagoda - *CJS Securities - Analyst*

Okay. I will hop back in queue. Thank you.

Operator

Our next question comes from the line of Mike Dahl with Credit Suisse. Please proceed with your question.

Mike Dahl - *Credit Suisse - Analyst*

Hi. Thank you for taking my questions. Just to start, I wanted to go back to the bookings comment around just the choppiness. It had been growing, you termed it a modest decline in 4Q. Wanted to see if you could add a little more color on both magnitude of that, and also if there was any specific end -- any channel or sector that was driving that weakness in bookings?

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

So one of the things we're seeing, Mike, is that the ABI mixed-use index really foreshadowed a softening in bookings that we saw. So it was consistent with that index. And where that index turned negative some months ago. It's been positive and continues to be, and that coincides with the level of quoting activity and the sentiment, which really has remained quite strong. I would say that we think that the level of activity in bookings will improve in the next month or so.

Mike Dahl - *Credit Suisse - Analyst*

Okay, thank you. Then shifting to the restructuring, so obviously, this has been something that the whole team and the new team has been working on, and wanted to get a sense of a little more granularity around what's involved here. Is this the extent of the restructuring that you're now planning? Or is this still step one or two, and you'll evaluate as you go on whether there's more? Just how many plants are involved? Is it as easy as saying, if you tell us that this could improve utilization by as much as 20%, that you're reducing 20% of your footprint? Or just how to think about this and the extent there.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

So this is the plan we alluded to. These are the costs for that plan as we see them now. And I don't want to go into detail about the specifics, other than to say we have a very definitive plan that we've been working on throughout this year. We're going to execute to that at an appropriate time and rate, and the benefits are very important to us. So again, I don't want to say a whole lot more about it other than it is a definitive plan and we're going to move ahead on it.

Mike Dahl - *Credit Suisse - Analyst*

And just following up, anything on cadence of the benefits? The $15 million to $20 million is over 12 to 36 months. Should we think about straight-lining that? Is it front-end loaded, back-end loaded?

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

I think the way to think about it, Mike, is in the next quarter or two as we speak about what we're doing, we'll be able to give some indication of how we're tracking on that number. We would rather talk about it after we do it, but it's clear that we put that number out there because that's where we're going.

Mike Dahl - *Credit Suisse - Analyst*

Okay. Thank you.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

And we'll move there, as quickly and as sensibly as we can.

Mike Dahl - *Credit Suisse - Analyst*

Got it. Thank you.

Operator

Our next question comes from the line of Trey Grooms with Stephens. Please proceed with your question.

Drew Lipke - *Stephens Inc. - Analyst*

Good morning. This is Drew Lipke on for Trey. Good quarter, guys.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Thank you very much.

Drew Lipke - *Stephens Inc. - Analyst*

The first -- going back to the choppiness, so I'm curious, do you feel like your -- like builders and your customers have somewhat caught up from the weather delays that we saw at the beginning of the construction season? It seems like we would have seen a more consistent increase in terms of just activity levels and square footage growth if there really was this pent-up demand in the pipeline. And it doesn't feel like we've really seen that. I'm curious if it was truly weather delays or do you guys think that maybe it's something more?

And then on those same lines, your backlog continues to grow at a very nice clip organically, but we're still not seeing that conversion into revenue quite yet. So how should we be thinking about where backlog stands today and just the conversion as we look into FY16?

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Well certainly, we saw the conversion in terms of volumes, as I said, our volumes are up from our legacy businesses by 14% sequentially.

Mark Johnson - *NCI Building Systems, Inc. - CFO*

12% [year over year].

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

That's right, and 12% on a year-over-year basis. We're quite pleased with the volumes there. With regard to the bookings, you can imagine we look at this very carefully on a weekly basis. And it is clear to us that our builder network has been very busy in the fourth quarter. It continued to be busy. And our sense is that when we look at the pipeline of jobs, specifically in the quoting activity, we are very confident that we're going to see bookings come back to a level that would be more consistent with the ABI index that foreshadowed the softness that we have seen and is foreshadowing a recovery as well in the near term.

Drew Lipke - *Stephens Inc. - Analyst*

Okay. And then October, November have seen some heavy rainfall across the southern US. Northeast has been pretty dry. Can you talk about any trends that you guys have seen here over the last month or so?

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

I got to tell you, this is one of the reasons why I started the script the way I did. Because I've been around here a long time, and I've never seen us reach a point that our commercial operating team and supply chain could be able to work as effectively as they did, to overcome the headwinds and deliver results. This is the first time in my 12 years I've seen an operation run as smoothly and as consistently and as disciplined as our teams did this year. This is not a one-time event. This is the way we're operating. It doesn't guarantee a whole lot other than we have good operational skills and we feel that we can better deal with headwinds than we've ever been able to deal before.

Drew Lipke - *Stephens Inc. - Analyst*

Okay. And then just final one for me, lower steel prices impacted revenue $20 million, $23 million in the quarter. You guys talked about it shifted product mix a little bit. I'm curious on the 240 basis points of the supply chain effectiveness that you call out and then the commercial discipline. How much of that is you benefiting from better buying power? And how should we think about the puts and takes there as we look into FY16 and the sustainability of this benefit?

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

To be sure, leaving aside the commercial discipline that Don Riley and the team have really demonstrated with great effect, John Kuzdal and the manufacturing folks and Dan Ronchetto on the supply chain side are really in lock-step in terms of uncovering and taking advantage of a whole host of advantages that we do have, whether it be transportation, improving that, whether it's our buying, whether it's our management of our inventory across the whole piece. It is a function of all three of our parts of our business that makes this happen. The commercial guys having better insights in the materials we need and when we need them. The supply chain doing a great job of delivering that. And John Kuzdal and the team doing a fabulous job of manufacturing.

Drew Lipke - *Stephens Inc. - Analyst*

All right. Thank you, Norm.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Yes.

Operator

Our next question comes from the line of Robert Wetenhall with RBC. Please proceed with your question.

Robert Wetenhall - *RBC Capital Markets - Analyst*

Hi, good morning.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Good morning.

Robert Wetenhall - *RBC Capital Markets - Analyst*

Just wanted to ask, Norm, your -- I wanted to understand a little bit better the narrative that you were talking about in your prepared remarks. It's obviously a solid quarter. And in your outlook, you gave what I would qualify as a restrained view of 2016. You used the words choppy twice and you used the word cautious. And so, I was trying to frame this in my mind and it sounds like tough conditions with good execution. Is that a fair way to frame it up? You're uncharacteristically somber on the outlook, and I'm just trying to understand that in the context. And is it like you're doing your own self-help initiatives inside to drive profitability in spite of this, but it's tough to fight against the overall trend? How should we be thinking about this?

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Just exactly as you just spoke about it.

Robert Wetenhall - *RBC Capital Markets - Analyst*

Okay. In terms of -- I'm just trying to understand. You got a large backlog. How is the backlog spread among the -- across the three businesses?

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Well, the backlog is just for the buildings group.

Mark Johnson - *NCI Building Systems, Inc. - CFO*

It's predominantly the buildings group. We do have the insulated metal panel product in there as well in the total backlog.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Yes, the total backlog of nearly $500 million is -- it includes the CENTRIA [in] the IMP piece. But the buildings is spread pretty nicely. We've got quite a good spread of activities. We're seeing, as we've alluded to a couple of times, larger types of projects, both that we have in our backlog and that which we're working on to hopefully get into our backlog. And that gives us -- the bigger jobs, as you know, Bob, extend out a bit. But we generally still turn our backlog in six to nine months.

Robert Wetenhall - *RBC Capital Markets - Analyst*

Okay. What are you guys expecting in 2016 on a volume basis for low-rise non-res construction? Is it low single digit? Is it mid-single-digit growth? How should we try to think about that on a volume-driven side?

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Sure. So we're really firmly in the view it's going to be 3% to 5%. McGraw -- I'm sorry, [Dodge] is at about 9%. And our view is if Dodge is right, God bless them, we'll be happy as can be. But we're gearing for an economic slow recovery and us grinding it out.

Robert Wetenhall - *RBC Capital Markets - Analyst*

Got it. And maybe, Mark, could you touch on the EBIT contribution and the rev contribution from CENTRIA in the quarter and what's going on with that?

Mark Johnson - *NCI Building Systems, Inc. - CFO*

Sure. So with CENTRIA, I think I mentioned it in my earlier comments. The EBIT contribution was about $3.7 million, and the EBITDA contribution was about $6.7 million.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

In the quarter.

Mark Johnson - *NCI Building Systems, Inc. - CFO*

In the quarter. And so CENTRIA, from a strategic standpoint and from an insulated metal panel aspect, is performing very strongly. The international parts of CENTRIA, which are a small part, but are a meaningful earnings contribution, are extremely weak for CENTRIA. So from that perspective, that would be lower than what we would have expected from CENTRIA about a year ago.

Robert Wetenhall - *RBC Capital Markets - Analyst*

Okay, and obviously to your comments, Mark, steel prices have been hit really hard this year. Doesn't seem like the trend is reversing. How do we think about the impact of lower steel prices, especially if they continue declining on profitability in each of the segments? We know revenues are going to move lower and that seems like a pass-through. But how does this impact profitability? Is it basically like you guys retain a stable margin in spite of, and that's the value-added component of NCS? Or am I not thinking about that the right way?

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

So I think you've got a really good model to look at in terms of the segment's performance in 2015. That was in a marketplace of decline that we think could possibly continue in 2016. And what that does drive, though, it does drive the fact that we and our competitors in the industry have an offering that really looks good comparing to traditional types of materials. So we would hope to see some pickup in the competitive advantage that we all have in regard to steel prices that are now lower.

Robert Wetenhall - *RBC Capital Markets - Analyst*

Does it affect pricing in the sense that how do you measure commercial discipline? Because you guys referenced that in your press release. How do you balance commercial discipline versus lower steel prices when you're thinking about that?

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

So we have different offerings. We in the components group have thousands of SKUs and we look very closely at value pricing when we can. We have a really very, very sophisticated, compared to the past, approach in the buildings group that is very mindful of the advantages that we have in our express buildings, which are very quick turn and we're very good at. We look at the value we add on the high complexity work and try to value price that. And then we stay as competitive as we can in that midrange. The marketplace is very competitive. Our competitors are very strong, but at the end of the day, the kind of performance we had in 2015 is really the kind of operational performance we expect to have.

Operator

Thank you. Our next question comes from the line of Matt McCall with BB&T. Please proceed with your questions.

Matt McCall - *BB&T Capital Markets - Analyst*

Thank you. Good morning, everybody.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Good morning.

Matt McCall - *BB&T Capital Markets - Analyst*

So help me understand your volumes, I think you said up 9% buildings, 15% components, yet starts are down, I think you said mid single digits. That was a year-to-date number, I don't know if something's changed more recently. But can you help me understand that disconnect, and is that -- is something going on in your markets where you could be -- your markets are growing stronger, or are you just taking share? Help me understand the disconnect there.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

We really are not in the share game. We're not -- we really want to stay very focused on the value and the value we bring. But I think we could be seeing, it's hard to tell, but we could be seeing what I spoke about to Bob Wetenhall just a second ago, that the lower steel prices are making our products more competitive against other, more traditional forms of construction. That could be part of it.

I think that the other thing that's really critical, and sometimes is underplayed, is the importance of the quality of our delivery of our products to our customers. Our ability to do that and meet their schedules and that relationship with our dealers and customers is critical. So I think it's a combination of things, but nevertheless, we're very pleased with what we were able to do on the volume side. And we'll continue to look for opportunities where we can get value pricing and move that along.

Matt McCall - *BB&T Capital Markets - Analyst*

And Norm, on the restructuring, you talked about one to three years, 12 to 36 months. Can you talk about what would make it one year? What would make it 36? Am I understanding that the right way? Is it dependent upon the pace of your demand improvement? What would cause it to be lengthened, or the benefit to be lengthened after three years?

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

So part of it is just making sure that whatever steps we take are executed perfectly. And executing perfectly means that all of our systems, in terms of IT systems and in terms of support and thoroughness of making sure that the capacity and the equipment is brought up to speed effectively, and doing that at a pace that's consistent with understanding that we have a seasonally strong period of the year that we want to make sure that we're not having disruptions by doing things like optimizing plants. We want to get that done during the slower seasons. So we'll see just how quickly we move. As I said, it's a clear plan. It's definitive. It has a schedule, which we're not sharing with the public. And we'll talk about it after we do it, and we'll be able to keep track of how we're doing on that number I put out.

Matt McCall - *BB&T Capital Markets - Analyst*

Okay. And then taking into account the cost savings, when you point to your double-digit EBITDA margin target and you've got the new cost savings that's going to be layered in, what revenue level do we need to see, to see 10%-plus EBITDA margin?

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Well, it's interesting, when we look at a quarter like the fourth quarter and the third quarter, and we look at what extra volumes do for us, it probably is more on the volume side than it is on the dollar side. It's how we can leverage up that volume both in terms of our commercial discipline and pricing it for value, as well as our manufacturing and supply chain for efficiencies and very strong cost focus.

Matt McCall - *BB&T Capital Markets - Analyst*

Okay. All right. Thank you, Norm.

Operator

Our next question comes from the line of Alex Rygiel with FBR Capital Markets. Please proceed with your questions.

Alex Rygiel - *FBR Capital Markets - Analyst*

Thank you and good morning.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Good morning.

Alex Rygiel - *FBR Capital Markets - Analyst*

Norm, as it relates to the $15 million to $20 million of annual savings from the actions (inaudible) some of your manufacturing capacity, have you included any of that in your views on gross margin in the near term?

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

No.

Alex Rygiel - *FBR Capital Markets - Analyst*

And when we think about your views on gross margin in 1Q of 2016 being flat to up 150 basis points, is that a similar range that -- I know you don't have annual guidance out there, but is it -- that within the realm of possibility for your annual view, or would you expect the annual view to be a little bit higher or lower?

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Well, as I said earlier, as we ramp up and comp back on a year-over-year basis, we would expect to probably see some slowing, but having -- knowing that's -- that we're comping back against better numbers as we get up to double digits, we're doing everything we can to try to have the best growth rate we can. So, I think that the way it plays out is that we want to do everything we can to have quarter-on-quarter improvement and to be able to measure that and you guys to see it.

Alex Rygiel - *FBR Capital Markets - Analyst*

And then, Mark, maybe I missed this, but could you quantify the negative impact on backlog that the lower steel prices had?

Mark Johnson - *NCI Building Systems, Inc. - CFO*

I don't think I did quantify that, but steel prices are roughly 20% lower than they were a year ago. And steel prices, broadly speaking, are about [50%] of our revenue. So maybe 10%.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Sure. I think that's a fair guess.

Alex Rygiel - *FBR Capital Markets - Analyst*

Very helpful. Thank you very much.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Thank you.

Operator

Our next question comes from the line of Scott Schrier with Citigroup. Please proceed with your question.

Scott Schrier - *Citigroup - Analyst*

Hi. Good morning. Nice quarter.

Mark Johnson - *NCI Building Systems, Inc. - CFO*

Good morning.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Thank you very much.

Scott Schrier - *Citigroup - Analyst*

So I wanted to ask you about your building margins. They seem to be the highest that they have been in quite some time. And I would think that some of that is attributed to the value pricing and the higher complexity projects you do. And those higher complexity projects that take longer were booked a while ago before steel prices declined, so you would have an incremental benefit from that. So I wanted to know, at this point, how is the bidding activity? Are your customers expecting lower pricing as a result of that? And how does that impact your outlook on the margins going forward?

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

It's clear that as I spoke about the advantage that we and our competitors should have in terms of being able to displace traditional forms of construction materials, that's based on having lower costs, that the value of what we're offering can comparatively advantage us against other forms of construction. So -- but that doesn't negate the fact that if we continue and have commercial discipline and be very focused on end markets, specific situations, the advantages we have in express buildings, we believe the very good position we have on high complexity work, as well, that there's opportunities for us to add more value and capture some of that value, and that's what we're -- that's what we try to do every day.

Scott Schrier - *Citigroup - Analyst*

Got it. And then with your current backlog, how do you predict capacity utilization going forward? And is there room there to fill up your plants with possibly more lower margin work?

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

That's a good question. We certainly are very mindful of our express buildings and the opportunity that gives us to backfill at any given time, because that's very quick turn work. And the team is really very good at that, and they are taking advantage of that at any given time. So, that forms a part of our strategy, for sure.

Scott Schrier - *Citigroup - Analyst*

Got it. And then one last one on coaters. It seems that you've reversed a trend; you had some margin compression for most of the year, and it looks like you had quite a bit of expansion this quarter year on year. If I understand the steel hedge correctly, weren't -- doesn't the steel hedge impact coaters negatively? I just wanted to see what was going on there.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Yes, it does. And again, the important thing to know about the coaters group is that we consume about 50% of the output internally. And therefore, we really have a team, Dan [Happel] and his team, they are very focused on the right customers, the right level of value we can bring to them, and really being very selective about who we add to our customer list, rather than chasing volume as we were a couple of years ago, which was, frankly, a mistake. And we're going to continue that way, so we're less concerned about the top line and more concerned about how we're adding good customers to complement the fact that we're advantaged because of the internal demand that we have. And that effectively enables us to cover all the fixed costs of the coating group by our internal needs. So we want to be really selective in how we approach our third-party sales.

Scott Schrier - *Citigroup - Analyst*

Great. Thank you. Appreciate you taking my questions.

Operator

(Operator Instructions)

Our next question comes from the line of Brent Thielman with D.A. Davidson. Please proceed with your question.

Brent Thielman - *D.A. Davidson & Co. - Analyst*

Hi, thank you. Good morning.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Good morning.

Brent Thielman - *D.A. Davidson & Co. - Analyst*

Just a clarification. On the Q4 bookings decline, is that across the board in terms of markets you serve, or was it in some very specific areas?

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

It was pretty much across. We've certainly -- as we've talked about before, we are very diversified. Our markets spread across all aspects of the economy. And we don't have any one of our end markets that's even approaching 5% of our backlog or our revenue. And I will say that the -- when I look at the backlog decline, it's pretty much across most things. And again, it was foreshadowed very, very aptly by the ABI index, when it sunk below 50 some months ago. And of course, that's recovered, and we're seeing at this time level of quoting activity that is really very good. We're seeing lots of work in the marketplace. And I think as that moves along, we'll see, and I'm sure our competitors will, that bookings improve.

Brent Thielman - *D.A. Davidson & Co. - Analyst*

Sure, and appreciating bookings can be pretty volatile quarter to quarter, you mentioned this good level of quoting activity. Is there a way we can think about where that's at relative to the last year or last few years in terms of quotation activity?

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

So, it's a little difficult to do that. But I'll say that from the perspective of us trying to have a balanced approach to the future, we take into account the economy is still very weak. It has a volatility to it that would impact us. And nevertheless, we would expect that as the bookings activity follow from the quoting activity and the opportunities in the marketplace, we'll get our share of work and we'll do the best to make money with that.

Brent Thielman - *D.A. Davidson & Co. - Analyst*

Okay. And then in terms of the capacity consolidation initiatives, I know more is going to come out in the next few quarters. Is this going to have the potential to maybe shrink your geographic exposure, to some extent, in terms of markets you serve, or still expect to be a national player here?

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

No, it will absolutely do the opposite. It will improve. It will improve our coverage of our customers. That's one of the reasons why we're taking this on. It gives us -- it improves our supply chain and improves our responsiveness to our customers.

Brent Thielman - *D.A. Davidson & Co. - Analyst*

Okay. And then just on insulated panels, I don't think we've talked too much on that. Any markets where you're seeing accelerated penetration there, successes, just love to hear how that particular product line is progressing?

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

I got to tell you that I'm really happy with our insulated metal panel team on the whole. We've seen the CENTRIA folks really move the dial in terms of the [hiring] architectural piece. They are doing a great job. We're seeing the Metl-Span folks really being focused and pushing their products in both the cold storage and the industrial and commercial and institutional piece. We've seen our internal sales continue to grow at 20% or more, which is a great thing because that means we're getting traction through our distribution channels. And we expect that to continue and still expect that the insulated metal panels will play an increasingly larger role in both our revenue and our bottom line.

Brent Thielman - *D.A. Davidson & Co. - Analyst*

Excellent. Thank you.

Operator

Our next question comes from the line of Stan (sic) McGovern with Credit Suisse. Please proceed with your question.

Sam McGovern - *Credit Suisse - Analyst*

Hi, guys. Thank you for taking my question. Just on the free cash flow, and as you guys get down toward your target debt leverage, any update in terms of what you're planning to do with that? How much for acquisitions, debt buybacks, or even trying to get a little bit below that target level?

Mark Johnson - *NCI Building Systems, Inc. - CFO*

So we anticipate that we'll get to the pre-acquisition leverage ratio maybe by the end of this upcoming year. We anticipate that during the year we will pay probably no less than $40 million down additionally on our debt. And the use of our free cash, other than that debt reduction, which is our primary focus at the moment and in the near term, is something that we consider every quarter. And we have very strong conversations with our Board, and we're very strategic with the use of that excess free cash flow. And so as that thought process develops, we'll be glad to share that with you.

Sam McGovern - *Credit Suisse - Analyst*

Great. Thank you so much. I'll pass it along.

Mark Johnson - *NCI Building Systems, Inc. - CFO*

Thank you.

Operator

Our next question is a follow-up question from Trey Grooms with Stephens. Please proceed with your question.

Trey Grooms - *Stephens Inc. - Analyst*

Hi, Norm. This is Trey.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Hi, Trey.

Trey Grooms - *Stephens Inc. - Analyst*

Congratulations on a good quarter.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Thank you, sir.

Trey Grooms - *Stephens Inc. - Analyst*

I just wanted to see if you guys could give us a little color update, with all of the changes you guys are making and are expected to make over the near term, which is going to lead to increased profitability, obviously, how should we be thinking about your take on the mid-cycle or earnings potential, or EBITDA potential or targets that you guys might have out there for the business?

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

I have tried to tone down my aspirational speak, but we still have the same goals. We think at mid-cycle, our trajectory as we've had for the last six quarters continues to, I think, underscore the opportunity. Certainly the mid-cycle recovery has been pushed out. This year looks like volumes will be negative to flat, even when they are adjusted.

Trey Grooms - *Stephens Inc. - Analyst*

Sure.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

So at the end of the day, we're still doing everything we can and double-digit EBITDA is a key component of that, Trey. And that's what we're focused on, my friend.

Trey Grooms - *Stephens Inc. - Analyst*

Okay. And that range, remind us, Norm. It seems like it was -- now that we've got CENTRIA and everything, should we be thinking somewhere in that [200, 250] range, mid-cycle? How should we be thinking about -- I just can't recall the exact numbers. We've had some moving pieces I know over the last year or two.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

We've had some moving pieces, and that's a safe bet.

Trey Grooms - *Stephens Inc. - Analyst*

Okay. Thanks a lot, Norm. Really appreciate it. Good luck.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Thank you.

Operator

We have reached the end of the question-and-answer session. I would now like to turn the floor back over to management for closing comments.

Norman Chambers - *NCI Building Systems, Inc. - Chairman, President and CEO*

Well, listen, thank you very much for joining us on the call, and I look forward to reporting in the first quarter. Thank you.

Operator

Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation, and have a wonderful day.

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